

AR23

*1978  
Annual  
Report*



*Lochiel Exploration Ltd.*

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## **CORPORATE PROFILE**

Lochiel Exploration Ltd. is an independent, Canadian-owned oil and gas company with production in western Canada and Ontario and broad exploration and development interests in the Beaufort Sea and the Canadian Arctic Islands. Lochiel also holds a one percent interest in the Buchan oil field in the U.K. sector of the North Sea where production is expected to begin this fall at an annual rate of 50,000 barrels per day (500 barrels per day net to Lochiel). Lochiel has 5.7 million shares outstanding and 1,625 shareholders. The Company's shares are listed on the Toronto and Alberta Stock Exchanges.



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## **ANNUAL MEETING**

Shareholders are cordially invited to attend the annual meeting of the Shareholders to be held at 3:00 p.m. Wednesday, June 27, 1979 in the Sheraton Centre Hotel, Toronto, Ontario.

## FINANCIAL AND OPERATING HIGHLIGHTS

Years ended January 31, 1978 and 1979

	1979	1978	Percent Increase (Decrease)
<b>Financial</b>			
Gross Revenue.....	\$2,010,000	\$1,801,000	12
Net income for the year.....	\$ 467,000	\$ 347,000	35
per share.....	8.1¢	6.1¢	35
Funds generated from operations .....	\$ 921,000	\$ 812,000	13
per share.....	16.0¢	14.2¢	13
Capital expenditures and exploration expenses.....	\$2,323,000	\$1,286,000	81
Total assets .....	\$9,776,000	\$7,467,000	31
Shareholders' equity .....	\$5,676,000	\$5,209,000	9
Shares outstanding .....	5,739,326	5,739,326	—
<b>Operations</b>			
Production — (gross before royalties)			
Crude oil and natural gas liquids — barrels .....	26,000	28,000	(7)
Natural gas — MCF .....	890,000	1,150,000	(23)
Land			
Working interest —			
gross acres.....	1,838,900	1,939,800	(5)
Working interest —			
net acres.....	1,157,000	1,226,100	(6)
Gross royalty acres.....	3,510,200	3,510,200	—
Drilling Activity			
Gross wells drilled.....	32	18	77
Net wells drilled.....	8	4	100
Net wells productive.....	6	2	200
Net wells dry .....	2	2	—
Reserves — (gross proven and probable)			
Crude oil and natural gas			
liquids — millions of barrels.....	1.31	1.30	—
Natural gas — BCF.....	24	22	9

# *Report to the Shareholders*

## **Review of 1978**

1978 was a year of significant achievement for Lochiel Exploration Ltd. This was reflected in the improved financial results and in the ground work laid which we expect will produce benefits for Lochiel in 1979 and in the years ahead. The most significant aspects of Lochiel's performance in 1978 were:

- Participation in a record total of 32 drilled wells, (11 oil, 11 gas and 10 dry) an increase of 77 percent over 1977.
- Capital expenditures for drilling and development of \$2.3 million, an historical high for Lochiel and 81 percent greater than 1977.
- The addition to our staff of a number of experienced, highly qualified exploration personnel.
- The placing of our first drilling fund, the Lochiel 78 Energy Program.

## **Financial and Operating**

Net earnings increased to \$467,000 in 1978, a gain of 35 percent from the previous year. On a common share basis net earnings per share were 8.1¢ compared with 6.1¢ in 1977. Funds generated from operations rose 13 percent to \$921,000 or 16.0¢ per common share from the \$812,000 or 14.1¢ in 1977.

Net revenues from oil and gas sales increased from \$1,206,000 in 1977 to \$1,308,000 in 1978, a gain of 8 percent. This increase was derived primarily from higher product prices and was achieved in spite of the fact that the company's major gas producing property, Atlee-Buffalo, was shut in for 18 weeks due to the well publicized Alberta gas surplus. In 1977 Atlee-Buffalo was shut in for 10 weeks.

Total net revenue from all sources increased from \$1,801,000 in 1977 to \$2,010,000 in 1978, a gain of 12 percent. This is in part due to gains of \$158,000 realized on foreign exchange futures contracts against our North Sea commitments.

Total expenses, net of income taxes, increased 15 percent to \$897,000 primarily due to increased operating costs and substantially higher interest charges on long term debt.

The most dramatic increase in 1978 was in capital expenditures and exploration expenses. The \$2,323,000 spent was 81 percent higher than 1977 and reflects the more aggressive posture taken in 1978. These expenditures exclude any monies spent on behalf of our investors in the drilling fund.

## **Exploration and Development**

Development drilling at the Buchan Field in the U.K. sector of the North Sea was completed early in December 1978 and the construction of the sub-sea system and loading buoy is proceeding on schedule. Completion of the seven wells from which the field will be produced began in November of 1978 and it is expected that oil production at a rate of 50,000 barrels per day (500 barrels net to Lochiel) will begin in October 1979. Lochiel has a one percent interest in the Buchan Field. Total development costs are now estimated to be £136 million (\$300 million Canadian).

Eighteen of the thirty-two wells drilled in 1978 were under the Lochiel 78 Energy Program. A total of 8 of the Lochiel 78 wells were successfully completed or cased as gas wells, 2 as oil wells, and the remaining 8 are dry and abandoned. Six drilling fund wells were remaining to be drilled at the end of the fiscal year, and it appears the fund will be successful. With a total fund of approximately \$1.8 million, we believe the investors and the Company were given exposure to a sizable number of interesting wildcat geological prospects while at the same time spreading the risk inherent in the exploration business.

The Board of Directors wishes to thank the investors who indicated their confidence in Lochiel by participating in this "first-ever" drilling fund.

On Lochiel's acreage, wildcat discoveries were made during 1978 at Buick Creek in northeast B.C. (gas well) and Taber in southern Alberta (oil well). Follow-up drilling at Taber has resulted in 3 additional oil wells.

Two development wells were drilled in Lake Erie, Ontario and they resulted in two new gas wells which are currently producing. Further drilling is planned in this area, located close to major markets, where Lochiel presently has 20 producing gas wells.

Drilling by Dome Petroleum Ltd. in the Beaufort Sea has indicated that the region contains natural gas and oil in potentially commercial quantities. Further testing, re-entries and new drilling this summer will further delineate the extent of reserves in the area. Lochiel with royalty and net carried interests ranging from 0.3 percent to 3.0 percent in over 1.7 million acres is well positioned to benefit from this activity.

In the Canadian Arctic Islands, where Lochiel has a working interest in over 900,000 gross acres and royalty interests in almost 700,000 acres, an application has recently been filed by Petro-Canada on behalf of the partners of the Arctic Pilot Project to export 250 million cubic feet of natural gas per day. The \$1.5 billion project will involve

drilling eight natural gas on-shore wells in the Drake Point field.

### Plans for 1979

The Company estimates expenditures for exploration, development and other activities of about \$3.5 million in 1979, an increase of 35 percent over 1978. Approximately one-half of this amount will represent development costs in the Buchan Field. The remainder will be spent in Canada, where Lochiel is planning an aggressive wildcat drilling program.

For the first nine months of 1979, the Company's expenditures will require bank financing. The need for financing is expected to diminish from September of 1979 when the Buchan Field is scheduled to come on production. Lochiel anticipates that the cash flow from all operations will then be in the area of \$3-4 million per year.

We are considering placing another drilling fund in 1979 in order to broaden our opportunities in Western Canada.

### Industry Outlook

Your Company is optimistic about the industry outlook for 1979. The recent report of the National Energy Board, "Canadian Natural Gas Supply and Requirements", indicates that additional gas exports to the United States may be approved in 1979. This would permit the sale of presently shut-in gas and allow current Canadian exploration and development activity to expand at an unprecedented pace.

In pricing, Ottawa and Alberta have reached agreement on two separate oil price increases: one to occur on July 1, 1979, the other on January 1, 1980. Also, it is expected that a 15¢ per thousand cubic feet increase in the price of natural gas will become effective July 1, 1979.

On the world oil price scene, the uncertainty in Iran and the apparent intentions of The Organization of Petroleum Exporting Countries (OPEC) to reduce production and increase prices at each indication of market disruption has pushed spot prices for crude oil beyond the \$20.00 U.S. level in some instances. OPEC raised its contract price to \$14.54 U.S. per barrel effective April 1, 1979 — surcharges placed on premium grades of oil could result in contract prices exceeding \$18.00 U.S. per barrel.

Canada's frontier oil and gas areas will attract greater interest over the next five years as it becomes increasingly apparent that we cannot depend on most foreign sources of petroleum. Attractive tax incentives should provide further inducement to undertake exploration activity in these areas.

In the Arctic Islands, the improvement of ice platform drilling techniques makes virtually all offshore

areas accessible. Many of the most attractive offshore structures will be evaluated over the next 5 years as part of an \$80,000,000 program to be carried out by the Arctic Islands group.

In the Beaufort Sea, we believe that second generation drill ships will permit year-round oil exploration, compared to the present 110 day season. This short drilling season makes the Beaufort Sea drilling program one of the most expensive in the world.

### Directors and Senior Personnel

During 1978, Lochiel Exploration Ltd. added to its staff in order to manage effectively its expanding exploration and development programs. Mr. Grant Auchincloss and Mr. Rick Smith joined the Company as Manager - Geology and Manager - Land respectively.

During the year, your Company was pleased to report the election of Mr. Timothy Melton, President of Melcor Developments Ltd. of Edmonton to the Board of Directors.

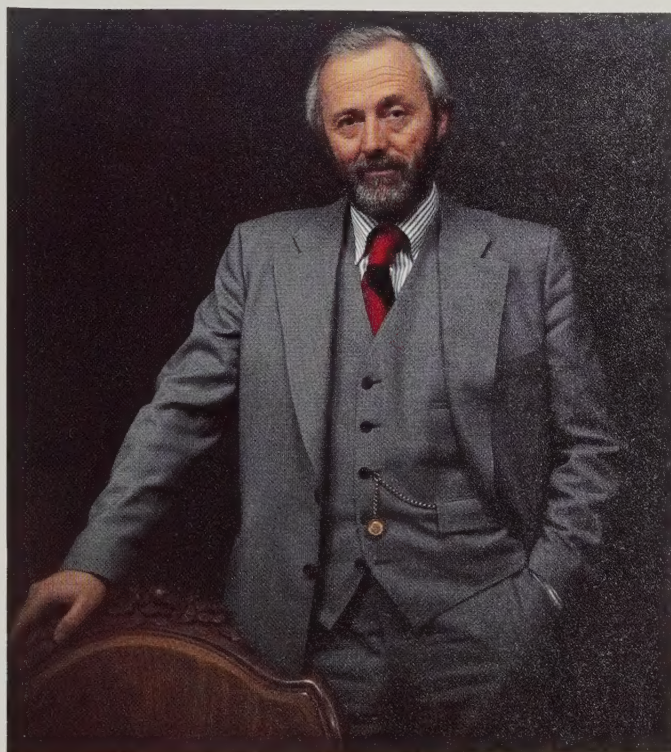
The Board of Directors accepted with regret during the year, the resignation from the Board of Mr. Ralph Scurfield and Mr. William Work. Both gentlemen served the Company for many years as Directors and they will be sorely missed.

Submitted on behalf of the  
Board of Directors



Nicholas W. Taylor  
President

April 4, 1979  
Calgary, Alberta



# NORTHWEST TERRITORIES

BRITISH COLUMBIA

ALBERTA

ATHABASCA OIL SANDS

LEGEND LAKE

MINK LAKE

BOHN LAKE

HOUSE MTN.

MARLBORO

Edmonton

PEMBINA

WHITFORD LAKE

BAXTER LAKE

WAINWRIGHT

GARRINGTON

SOUTH ALIX

KESSLER

PROVOST

SUNNYNOOK

Calgary

QUIRK CREEK

SHOULDICE

ATLEE-BUFFALO

TABER

Lochiel Interests

64 0 64 Miles

UNITED STATES

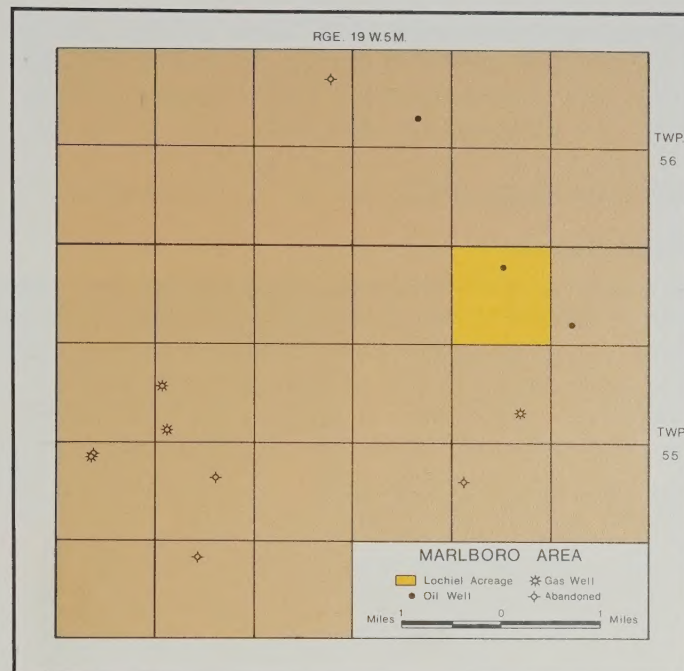
SASKATCHEWAN

# Exploration and Development

## DRILLING ACTIVITY

Lochiel Exploration Ltd. was successful in conducting an expanded domestic exploration program while also meeting the significant financial requirements of its North Sea development program. The Company followed a strategy of undertaking relatively smaller interests in a variety of wildcat prospects which offered attractive upside potential in Western Canada. The results were of great encouragement to the Company and give an impetus for 1979 and beyond.

The following table shows that Lochiel participated in 32 wells, 27 of which were in Canada. This drilling program resulted in 12 successful exploratory wells, all in Canada, and 10 successful development wells, 5 in Canada and 5 in the U.K. Our exploration department was extremely selective in its choice of drilling prospects, which resulted in high success ratios compared to previous years. Our goal for the future is to maintain this level of success while committing our expanding cash flow and possibly drilling funds to further exploration.



## Whitford Lake

The Lochiel 78 Energy Program participated in the drilling of two discoveries in the Whitford Lake area of eastern Alberta. The well located in 11-10-53-15W4M flowed gas from the Viking and Colony sands at a daily rate of 2.4 million cubic feet on drill stem test. The second discovery is presently being evaluated. Production is expected in 1979 and further drilling is planned on the 3,840 acre block in which Lochiel and its drilling fund partners have an 18 percent interest.



## 1978 Drilling Results

Total Wells: (Direct and Indirect Participation)

	Gross Working Interest	
	1978	1977
<b>EXPLORATORY</b>		
Oil .....	3	2
Gas .....	9	—
Dry .....	8	6
<b>DEVELOPMENT</b>		
Oil .....	8	1
Gas .....	2	6
Dry .....	2	3
<b>Total .....</b>	<b>32</b>	<b>18</b>

## Geographical Distribution of Drilling

	Gas	Oil	Dry	Total
Alberta .....	6	6	8	20
British Columbia .....	3	—	—	3
Saskatchewan .....	—	—	2	2
Ontario .....	2	—	—	2
North Sea (U.K. Sector) .....	—	5	—	5
<b>Total .....</b>	<b>11</b>	<b>11</b>	<b>10</b>	<b>32</b>

## ALBERTA

### Marlboro

Leddy Lochiel Marlboro, located in 15-35-55-19W5M has been completed as a Cardium oil well. The three Cardium sands which are present contain approximately 28 feet of net oil pay. This well was drilled under the Lochiel 78 Energy Program, with Lochiel and its drilling fund partners earning a 30 percent interest in the drilled section. Lochiel expects to begin trucking crude oil in two months, subject to road bans. Follow-up drilling is planned on this section and on option lands adjacent to the well.

## Other Drilling

During 1978, Lochiel participated in the drilling of four oil wells in the Taber area of southern Alberta. Lochiel's interest varies from 12.5 percent to 25 percent in 1,760 gross acres.

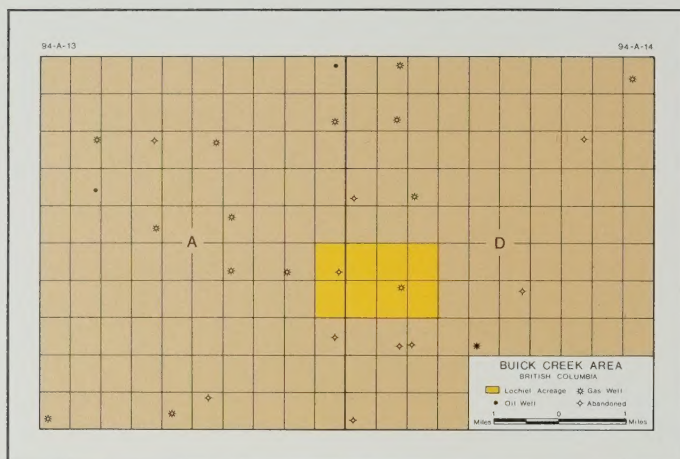
In one well at Kessler in east-central Alberta, production casing was run to the Viking sand after a test flowed gas at a rate of 2.5 million cubic feet per day. This well was drilled under the Lochiel drilling fund which retains a 37.5 percent interest until payout and an 18.75 percent interest after payout in 640 acres.

Other successful wells were drilled by the Lochiel 78 Energy Program in central Alberta at Provost (gas well), South Alix (gas well), Sunnynook (gas well) and at Shouldice (gas well).

## BRITISH COLUMBIA

### Buick Creek

The Czar et al Fireweed d-39-D/94-A-14 well was completed in 70 feet of net pay in the Dunlevy zone after testing 2.1 million cubic feet per day. This well has been tied-in to the gathering system and was placed on production in January of 1979 under existing contracts. Lochiel has a 12.5 percent working interest in this well.



### Red Creek

At Red Creek in northeast British Columbia where Lochiel and its fund partners have a 12.5 percent interest in 9 sections, the well, Orbit et al Red Creek 6-18-85-20W6M has been cased as a gas well in the Upper Halfway sands. Tests have been inconclusive to date and further drilling is planned.

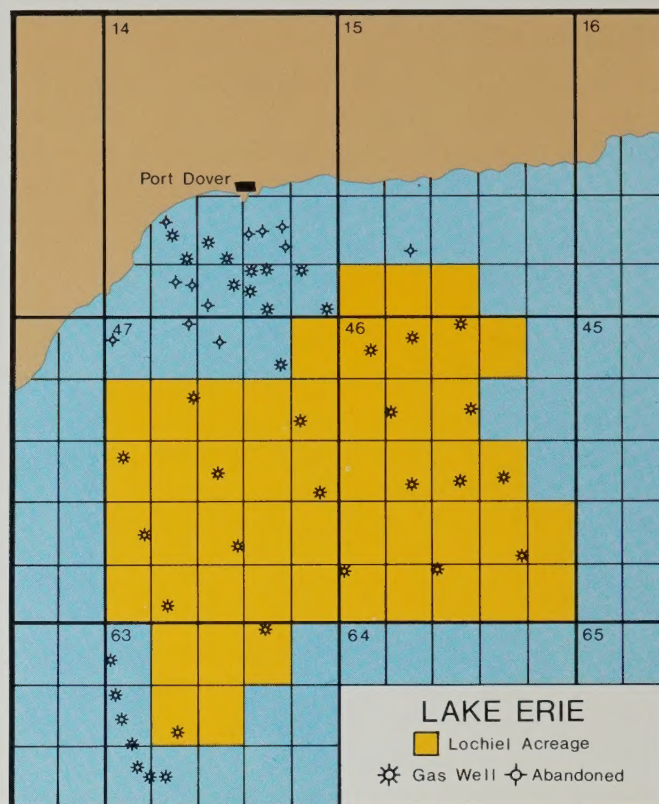
### Aitken Creek

The Czar et al Aspen c-40-J/94-A-13, also drilled under the drilling fund, encountered gas in both the Coplin and Baldonnell formations. Lochiel and its partners earned an interest in more than 2,000 acres by participating in this well.

## ONTARIO

### Lake Erie

The Company has a 58.67 percent working interest in leases covering over 31,000 acres in the Lake Erie area of Ontario. In 1978, Lochiel participated in the drilling of two Grimsby gas wells on this acreage. There are now 21 gas wells producing or capable of production from this formation. Production rates in the region have shown considerable improvement in recent months due to more efficient production techniques. This fact, combined with attractive gas prices and ready markets in the area should result in further development drilling in 1979.



## BEAUFORT SEA

Dome Petroleum Limited has covered a wide variety of well sites in its three seasons of exploratory drilling in the Beaufort Sea. Three potential structures have been evaluated with deep tests.

1. Kopanoar M-13 was drilled to 9,164 feet in 1977 and deepened to over 14,000 feet in 1978. The well has not been tested but is rumored to contain significant recoverable oil and, possibly, gas reserves.
2. Ukalerk 2C-50 was drilled to 16,000 feet in 1978 and has indicated three potential zones of oil and gas. The well was not tested.
3. Nektoralik K-59 was drilled to 9,150 feet in 1977 and encountered extremely high pressure, making further drilling impractical. Dome has indicated that, when testing the structure, oil flowed from the lower zone, oil and gas from the middle zone, and gas and condensate from the upper zone. No water was indicated in any zone.

Dome is expected to resume its Beaufort Sea program in May of 1979, with five well sites selected and five additional sites possible. The five selected sites, Kilannak M-76, Nerlerk M-98, Kaglulik M-64, Natsek E-56 and Tarsiut A-25 are to be drilled to a target depth of 12,000 - 13,000 feet and drilling is expected to continue to December, weather permitting.

The accompanying map shows Lochiel's large royalty holdings and net carried interests in the vicinity of the recent Dome activity. Lochiel interests are as follows:

#### Acreage Held

#### Interest

686,000 acres	3	% gross over-riding royalty
825,000 acres	1.40	% net carried interest
	0.567%	gross over-riding royalty
213,000 acres	0.3	% gross over-riding royalty



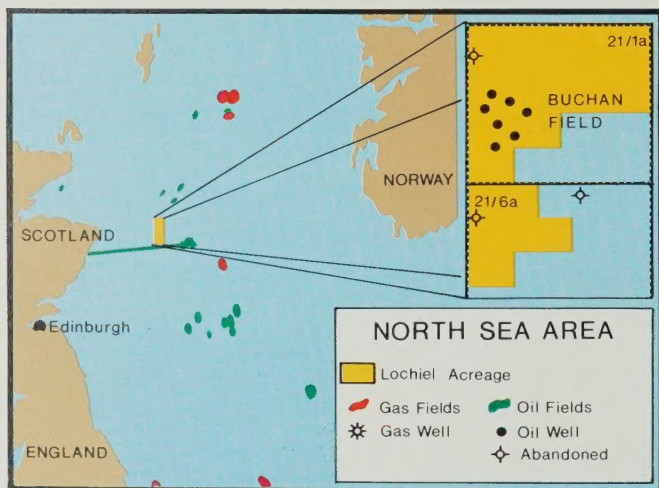
## ARCTIC ISLANDS

Panarctic Drake F-76 drilled in 1978 is the first Arctic well to be successfully completed and equipped for production in the offshore Arctic Islands. This well demonstrates that the large quantities of oil and gas that exist underwater in this region can be produced. It also represents further progress in solving the complex problem of bringing these reserves to market. A consortium of Petro-Canada, Alberta Gas Trunk Line and Melville Shipping Ltd. recently filed an application with the National Energy Board to ship liquid natural gas from Melville Island to eastern Canada by using icebreaking carriers. This proposal is distinct from the Polar Gas pipeline application to bring gas overland to central North America.

## FOREIGN EXPLORATION AND DEVELOPMENT

### The Buchan Field

An important aspect of our activity during the past year was the progress made in bringing the Buchan Field closer to production. Lochiel owns a one percent interest in Buchan, which is located in the U.K. sector of the North Sea, approximately 100 miles north and east off the coast of Aberdeen, Scotland.



The reservoir is estimated by independent consulting engineers to contain approximately 50 million barrels of proven, recoverable reserves and another 50 million barrels of probable and possible reserves. Consent was given by the U.K. Department of Energy in March, 1978, to a proposed plan for development which provides for production at an initial average rate of 50,000 barrels per day (500 barrels per day to Lochiel) beginning in late 1979.

The development program has been progressing on schedule. Five development wells were drilled directionally from a template, and two flank wells were drilled a mile to the south. These wells are being completed with the well heads located on the

ocean floor approximately 400 feet below the surface. The completed wells will be connected by subsea flowlines to the central template. From this template the oil flows through a group of flowlines, called a riser, to the surface. The riser connects with a floating production platform anchored on the surface.

When it reaches the surface, the oil is treated on the floating facility and pumped back down through another part of the riser along a one-mile seafloor transfer line and a flexible hose to a loading buoy. The loading buoy also serves as the mooring for the tankers which receive the oil. All subsea equipment can be operated by a remote control system which is contained in the riser.

Construction of the subsea components, loading buoy, and production platform is virtually finished. The seafloor equipment installation has recently started and is scheduled to be operational this fall. Two tankers have been selected for transportation of the oil to markets. This system of production (using a floating platform) is only the second of its kind in the world.



### Other Foreign Activities

Most of Lochiel's efforts in 1978 were directed towards the development of our Buchan production, although the Company does continue to maintain its interest in an oil and gas concession in Italy. Recent attempts to obtain drilling concessions in the U.K. sixth round were unsuccessful.

### BAKER LAKE — MINING PERMITS

Lochiel has an interest in 288,000 acres (25,000 net acres) at Baker Lake on the western shore of Hudson's Bay. Uranium deposits were discovered at shallow depths in 1975 and 1976, but were determined to be uneconomic at that time. With recent price increases for uranium and increased energy needs, Lochiel and its partners are planning to drill additional and deeper exploration tests in 1979.

## Land Holdings

As of January 31, 1979, Lochiel held working interests in a total of 1,157,000 net acres. During the year, the Company added more than 4,000 net acres in the high cost areas of Alberta and north-eastern British Columbia and dropped a 74,000 acre concession in Turkey for a net decline of 70,000 acres from 1977. The Company was able to hold its acreage in the Canadian frontier areas

through farm-outs and work credits at almost no direct cost.

In addition to working interest acreage, Lochiel holds royalty interests in 3,510,157 acres, mainly located in Canada's frontier areas. These interests are unchanged from 1977.

### PETROLEUM AND NATURAL GAS RIGHTS

as of January 31, 1979

#### Working Interest Properties

Geographical Area	Gross Acres	Net Acres
Alberta .....	163,200	59,973
British Columbia .....	6,447	1,341
Saskatchewan .....	11,346	11,101
Ontario .....	31,250	18,334
Arctic Islands .....	929,260	649,045
Eastcoast Offshore .....	550,576	412,932
<b>TOTAL CANADA .....</b>	<b>1,692,079</b>	<b>1,152,726</b>
North Sea (U.K.) .....	54,200	542
Italy .....	92,617	3,705
<b>TOTAL FOREIGN .....</b>	<b>146,817</b>	<b>4,247</b>
<b>TOTAL .....</b>	<b>1,838,896</b>	<b>1,156,973</b>

#### Royalty Interest Properties

Geographical Area	Gross Royalty Acreage
Alberta .....	136,360
Arctic Islands .....	695,099
Beaufort Sea/MacKenzie Delta .....	1,723,880
Northwest Territories .....	162,164
Yukon Territory .....	385,608
Pacific Offshore .....	243,386
Eastcoast Offshore .....	163,660
<b>TOTAL .....</b>	<b>3,510,157</b>

## Reserves

The Company's gross recoverable proven reserves which are presented in the table below are calculated after deducting working interests owned by others, but before deducting Crown and freehold royalties. The domestic Canadian proven reserves were determined by McDaniel Consultants at January 1, 1978, and updated by our staff to reflect additions and production since that date. The North Sea reserves have been calculated by the operator of the Buchan Field project and by independent consulting firms. Proven reserves have not been

assigned to any of the properties in which Lochiel holds overriding royalties.

The additions to proven oil and gas reserves during 1978 exceed by 74,000 barrels or barrel equivalents the total of the year's production. The most significant additions resulted from an oil discovery at Marlboro and gas discoveries at Whitford Lake, Buick Creek and Shouldice. Development drilling at Lake Erie also contributed to new gas reserves.

	Natural Gas Liquids (Barrels)	Natural Gas (MCF)	Crude Oil Domestic (Barrels)	Crude Oil Foreign (Barrels)	Total Barrel Equivalents*
Proven reserves					
January 31, 1978 .....	31,000	19,201,000	160,000	500,000	3,891,000
Additions during the year .....	—	1,150,000	55,000	—	247,000
1978 Sales .....	(1,000)	(881,000)	(25,000)	—	(173,000)
Proven reserves					
January 31, 1979 .....	30,000	19,470,000	190,000	500,000	3,965,000

\* Conversion ratio to determine barrel equivalents: 1 barrel oil = 6 MCF natural gas = 1 barrel liquids.

# Production

## Natural Gas

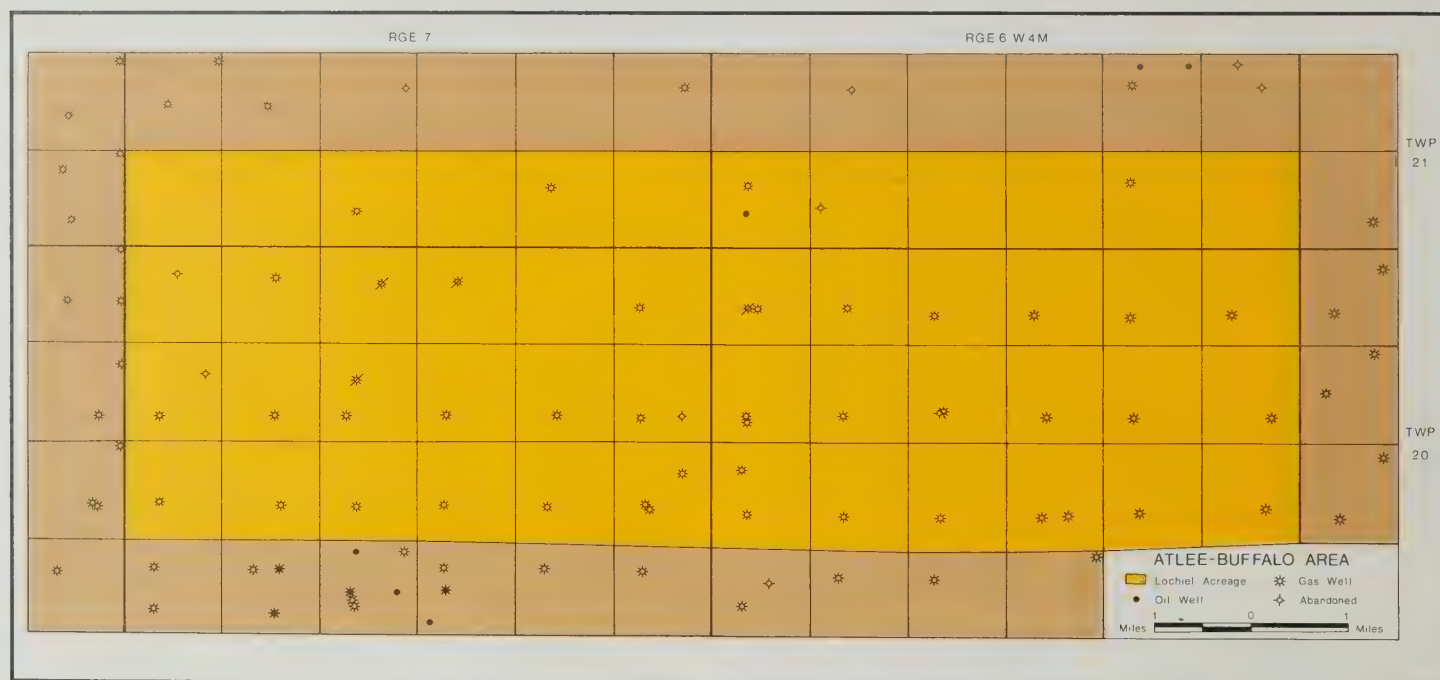
Lochiel's three major gas producing areas are Atlee-Buffalo and Garrington in Alberta and Lake Erie in Ontario. During the past fiscal year, the Company's sales of natural gas before royalties were 890,000 MCF, which was down 23 percent from 1977. The decline resulted primarily from the 18 week shut-in of our Atlee-Buffalo property due to the over-supply situation in Western Canada. Production increases in Lake Erie were not enough to offset this decline.

The Company has interests in three gas producing areas scheduled to go on production in 1979. These are Buick Creek in British Columbia, Whitford Lake and Kessler in Alberta. Two new development wells drilled in Lake Erie will contribute a full year's production in 1979 compared to six months in 1978. Collectively, production from all these wells should enable the Company to reverse the recent trend of declining gas production.

## Crude Oil

The Company produces 90 percent of its oil from five areas: House Mountain, Virden-Roselea, Baxter Lake, Wainwright and Garrington. Production remained flat at 26,000 barrels in 1978 as no new areas came on production.

Three new oil producing areas are expected to contribute significantly to production in 1979. The Buchan Field is scheduled to go on production in the fall of 1979 and is expected to produce in excess of 50,000 barrels of crude oil for Lochiel before the year end. Other properties at Marlboro and Taber will also be placed on full production during the year.



## Market Information

The shares of Lochiel Exploration Ltd. are listed for trading on the Toronto and Alberta Stock Exchanges. The ticker symbol is LHX. Management and Directors own directly and indirectly approximately 3,300,000 shares of the 5,739,326 out-

standing. The remainder are widely held by over 1600 shareholders. The high and low prices of the Company's shares on the Toronto Stock Exchange for the last two years are shown below:

Calendar Year	1st Quarter		2nd Quarter		3rd Quarter		4th Quarter		Volume of Shares Traded
	High	Low	High	Low	High	Low	High	Low	
1977.....	\$ 1.75	\$ 1.38	\$ 1.68	\$ 1.23	\$ 2.47	\$ 1.42	\$ 3.25	\$ 2.06	2,562,394
1978.....	\$ 2.38	\$ 1.95	\$ 3.85	\$ 2.19	\$ 4.30	\$ 2.60	\$ 3.50	\$ 2.45	4,140,700

# Financial Review

## Operating Results

In spite of the fact that the Company's major producing property, Atlee-Buffalo, was shut-in for 18 weeks in 1978 and that the Buchan oil field was not yet on production, Lochiel's revenue, net earnings and cash flow from operations all showed increases in 1978 as compared to 1977. Net earnings increased 35 percent to \$467,000 in 1978 from \$347,000 in 1977; cash flow increased 13 percent to \$921,000 in 1978 from \$812,000 in 1977 and revenue rose 12 percent to \$2,010,000 in 1978 from \$1,801,000 in 1977. Approximately 93 percent of the 1978 revenue was derived from production and 7 percent from other income, including a realized gain of \$158,000 on foreign exchange future contracts related to the Company's U.K. operation.

Higher product prices were the major contributors to production revenue gains. On the expense side, operating costs continued to increase due to inflation although abnormally high costs of operations of a non-recurring nature at Atlee-Buffalo also contributed. Overall operating costs are not expected to increase significantly in 1979.

Royalties and mineral taxes were reduced in 1978 as production declined in the higher royalty areas such as Alberta but increased in other areas such as Ontario where the royalty structure is lower.

The Company continues to absorb substantial interest costs, a trend which will continue until the Buchan Field is placed on production in September 1979.

Depletion and depreciation declined in spite of substantially increased capital expenditures in 1978, primarily because the major portion of these expenditures was made on oil and gas discoveries which have not yet been placed on production, and on development projects (mainly Buchan) which are not yet on production. The Company expects to place at least 10 wells on production in 1979 which should result in significantly higher depletion and depreciation charges.

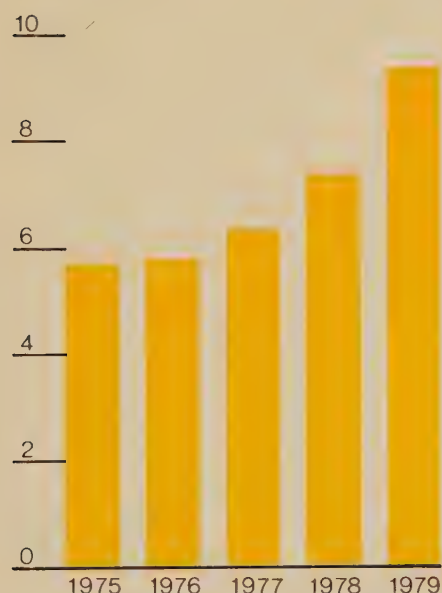
## Financial Position

Capital expenditures in 1978 reached an all time high of \$2,323,000, an increase of 81 percent over 1977. These expenditures were the result of Lochiel's active drilling program in Canada and extensive commitments in the Buchan Field.

Funds generated from operations and other sources were insufficient to cover capital expenditures, debt retirements and other requirements for funds. Consequently, working capital dropped from \$434,000 in 1977 to \$269,000 in 1978, and the Company increased its bank loans from \$1,414,000 to \$2,571,000. Included in other sources of funds is \$156,000 representing payments received from gas purchasers who did not take delivery of the minimum volumes for 1978 as provided in the contracts. Such payments are treated as deferred revenue and will not be included in earnings results until the gas is delivered or the "make-up" period expires.

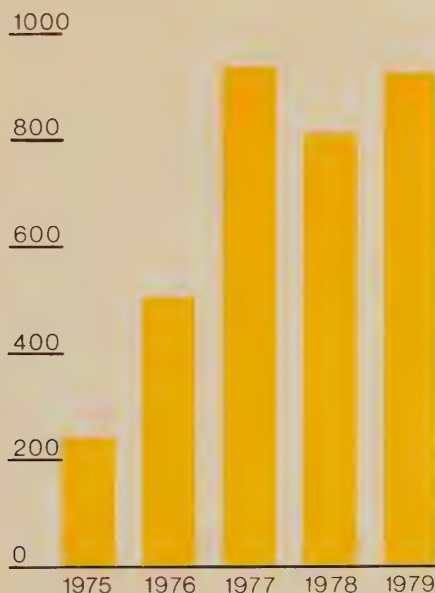
### Capital Employed

(millions of dollars)  
as at January 31, 1979



### Funds from Operations

(thousands of dollars)  
as at January 31, 1979



### Net Income

(thousands of dollars)  
as at January 31, 1979



# *Lochiel Exploration Ltd.*

and Subsidiary Companies

## **CONSOLIDATED BALANCE SHEET**

AS AT JANUARY 31, 1979

	1979	1978
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash .....	\$ 75,255	\$ 17,652
Accounts receivable .....	445,614	241,800
Provincial royalty tax credit .....	122,253	255,774
Prepaid expenses .....	—	6,636
	643,122	521,862
INVESTMENTS AND LONG-TERM RECEIVABLES (Note 2) .....	616,152	540,154
<b>PROPERTY, PLANT AND EQUIPMENT, AT COST</b>		
Oil and gas properties .....	8,997,143	6,750,629
Production equipment .....	1,115,330	1,052,820
Other .....	27,452	13,036
	10,139,925	7,816,485
Less accumulated depletion and depreciation .....	1,623,019	1,411,112
	8,516,906	6,405,373
	<u>\$ 9,776,180</u>	<u>\$7,467,389</u>

Signed on behalf of the Board



Director



Director

**LIABILITIES**

## CURRENT LIABILITIES

Accounts payable. ....	\$ 374,328	\$ 87,942
DEFERRED GAS CONTRACT REVENUE (Note 3) .....	156,080	—
PRODUCTION LOANS (Note 4) .....	2,571,000	1,413,621
DEFERRED INCOME TAXES .....	998,843	756,753
	<u>4,100,251</u>	<u>2,258,316</u>

**SHAREHOLDERS' EQUITY**

## SHARE CAPITAL (Note 5)

Authorized		
10,000,000 shares of no par value		
Issued		
5,739,326 shares .....	5,514,160	5,514,160
RETAINED EARNINGS (DEFICIT) .....	161,769	(305,087)
	<u>5,675,929</u>	<u>5,209,073</u>
	<u>\$ 9,776,180</u>	<u>\$7,467,389</u>

# *Lochiel Exploration Ltd.*

and Subsidiary Companies

## **CONSOLIDATED STATEMENT OF INCOME**

FOR THE YEAR ENDED JANUARY 31, 1979

	1979	1978
REVENUE		
Oil and gas sales .....	\$1,834,894	\$1,795,562
Less royalties and mineral taxes .....	526,950	589,998
Net sales .....	1,307,944	1,205,564
Gain on foreign exchange contract .....	157,805	—
Other income .....	17,729	5,829
	<u>1,483,478</u>	<u>1,211,393</u>
EXPENSES		
Operating .....	411,456	259,996
General and administrative .....	156,256	183,408
Interest on long-term debt .....	117,590	88,943
Depletion and depreciation .....	211,907	247,986
	<u>897,209</u>	<u>780,333</u>
Income before income taxes .....	586,269	431,060
INCOME TAXES		
Current — Provincial royalty tax credit .....	(122,677)	(133,715)
Deferred .....	242,090	218,140
	<u>119,413</u>	<u>84,425</u>
Net income for the year .....	<u>\$ 466,856</u>	<u>\$ 346,635</u>
Net income per share (based on average number of shares outstanding during the year) .....	<u>8.1¢</u>	<u>6.1¢</u>

## **CONSOLIDATED STATEMENT OF RETAINED EARNINGS**

FOR THE YEAR ENDED JANUARY 31, 1979

DEFICIT AT BEGINNING OF YEAR .....	\$ (305,087)	\$ (651,722)
Net income for the year .....	466,856	346,635
RETAINED EARNINGS (DEFICIT) AT END OF YEAR .....	<u>\$ 161,769</u>	<u>\$ (305,087)</u>

# *Lochiel Exploration Ltd.*

and Subsidiary Companies

## **CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION**

FOR THE YEAR ENDED JANUARY 31, 1979

	1979	1978
SOURCE OF FUNDS		
From operations		
Net income for the year .....	\$ 466,856	\$ 346,635
Add items not requiring current outlay of funds		
Depletion and depreciation .....	211,907	247,986
Deferred income taxes .....	242,090	218,140
Other .....	—	(993)
FUNDS FROM OPERATIONS .....	920,853	811,768
Increase in production loans .....	1,657,507	909,424
Decrease in investment and long-term receivables .....	51,110	3,993
Deferred gas contract revenue (Note 3) .....	156,080	—
Issue of shares .....	—	106,800
	2,785,550	1,831,985
USE OF FUNDS		
Property, plant and equipment .....	2,323,440	1,285,989
Repayment of production loans .....	500,128	394,245
Increase in investments and long-term receivables .....	127,108	20,512
Reduction of prepaid production revenue .....	—	126,293
	2,950,676	1,827,039
INCREASE (DECREASE) IN WORKING CAPITAL .....	(165,126)	4,946
WORKING CAPITAL AT BEGINNING OF YEAR .....	433,920	428,974
WORKING CAPITAL AT END OF YEAR .....	\$ 268,794	\$ 433,920

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JANUARY 31, 1979

### 1. Summary of Significant Accounting Policies

- (a) Principles of Consolidation  
The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Lochiel Exploration (U.K.) Limited, Lochiel Oil and Gas (1972) Ltd., Lochiel Exploration Inc., (inactive) and its proportionate share of a drilling fund.
- (b) Foreign Currency Transactions  
Foreign currency transactions are converted to equivalent Canadian dollars on the basis of the exchange rate prevailing at the date of transaction.
- (c) Joint Ventures  
The Company conducts substantially all of its oil and gas exploration and production activities on a joint venture basis.
- (d) Exploration and Development Costs.  
The Company follows the full cost method of accounting. Under this concept, all costs relating to the exploration for and the development of oil and gas reserves, including related overhead costs, are capitalized. Proceeds from disposal of properties are normally deducted from costs without recognition of gain or loss.
- (e) Depletion and Depreciation  
Depletion of exploration and development costs and depreciation of production equipment related to Canadian operations, except frontier areas, are computed under the unit of production method based on estimated proven oil and gas reserves. Costs related to Canadian frontier areas and foreign areas are carried in separate cost centres on which amortization is deferred pending the outcome of exploration.
- (f) Deferred Income Taxes  
The Company follows the tax allocation method of accounting under which the income tax provision is based on the earnings reported in the accounts. Under this method, the Company provides for deferred income taxes to the extent that income taxes otherwise payable are eliminated by claiming capital cost allowances and exploration and development costs in excess of the depreciation and depletion provisions recorded in the accounts.

### 2. Investments and Long-Term Receivables

	1979	1978
Investment and advances — Petromines Limited. ....	\$345,760	\$231,822
Investment in shares of other companies. ....	712	712
Notes receivable from employees, at cost. ....	235,160	286,270
Refundable deposits, at cost. ....	34,520	21,350
	<u>\$616,152</u>	<u>\$540,154</u>

The Company holds 942,281 shares (approximately 26%) of the issued capital of Petromines Limited, of which 413,281 shares are subject to an escrow agreement. These shares have been recorded at cost less a valuation allowance of \$182,027.

Notes receivable from employees totalling \$235,160 remain outstanding as consideration for shares purchased under employee stock purchase and option plans. The notes are non-interest bearing and mature between 1980 and 1984.

### 3. Deferred Gas Contract Revenue

The Company has a "take or pay" gas purchase contract with TransCanada PipeLines Limited under which TransCanada is obligated to take a determined minimum quantity of gas during a contract year. Failing to take the minimum quantity requires TransCanada to pay the Company at current prices for gas not taken with the right to take delivery of such gas paid for, but not taken, any time within the next ten years. Such gas can only be taken in quantities which exceed the minimum contract quantities of any contract year. The value of the gas not taken during the current contract year amounted to \$156,080 and it is anticipated that TransCanada will not take delivery of such gas in 1979.

### 4. Production Loans

The bank production loans are evidenced by demand promissory notes and are secured on assignment of book debts and by oil and gas properties. The loans are repayable out of future production proceeds and, accordingly, are not expected to require the use of existing working capital.

### 5. Share Capital

	1979		1978	
	Number of shares	Share capital	Number of shares	Share capital
Balance at beginning of year.....	5,739,326	\$5,514,160	5,679,326	\$5,407,360
Issued for cash under Employee Share Purchase Plan ...	—	—	60,000	106,800
	5,739,326	\$5,514,160	5,739,326	\$5,514,160

At January 31, 1979, officers and employees held options to purchase a total of 183,000 shares of the Company for prices ranging from \$2.15 to \$2.75 per share and exercisable from time to time over a five year period ending in 1984.

### 6. Commitments

- (i) The Company has issued non-interest bearing promissory notes and guarantees totalling \$55,000 in favour of various governmental authorities as security for exploratory commitments.
- (ii) Under a joint interest agreement covering the exploration and development of the Buchan Field in the U.K. sector of the North Sea, the Company is to contribute as its share of the project approximately 826,000 pounds sterling during the period 1979-81.

### 7. Remuneration of Officers and Directors

The aggregate direct remuneration of directors and officers is as follows:

	Number	Amount
Directors.....	6	\$ 7,200
Officers, of whom two were also directors.....	4	\$155,600

## **AUDITORS' REPORT**

The Shareholders  
Lochiel Exploration Ltd.

We have examined the consolidated balance sheet of Lochiel Exploration Ltd. as at January 31, 1979 and the consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly, included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at January 31, 1979 and the results of its operations and the changes in its financial position for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Alberta  
March 23, 1979

Touche Ross & Co.  
Chartered Accountants

# Lochiel Exploration Ltd.

## FIVE YEAR STATISTICAL REVIEW

AT JANUARY 31

(dollar amounts in thousands except per share amounts)

### FINANCIAL

#### Income Statement

	1979	1978	1977	1976	1975
Oil & gas sales .....	\$1,835	\$1,796	\$1,806	\$ 1,041	\$ 655
Royalties paid .....	527	590	537	264	136
Net oil & gas sales .....	1,308	1,206	1,269	777	519
Interest & other income .....	175	6	3	2	13
	1,483	1,212	1,272	779	532
Production expenses .....	411	260	201	172	142
General & administrative .....	156	183	139	97	100
Interest expense .....	118	89	123	78	101
Provincial royalty tax credit .....	(123)	(133)	(122)	(72)	(58)
	562	399	341	275	285
FUNDS GENERATED from operations ...	921	812	931	504	247
Per share .....	16.0c	14.2c	16.0c	8.6c	4.4c
Depreciation, depletion & amortization	212	247	289	249	78
Deferred income taxes .....	242	218	234	103	91
Other items .....	—	—	(63)	258	94
	454	465	460	610	263
NET INCOME (loss) .....	\$ 467	\$ 347	\$ 471	\$ (106)	\$ (16)
Per share .....	8.1c	6.1c	8.1c	(1.8)c	(0.3)c

#### Balance Sheet

Working capital .....	\$ 269	\$ 434	\$ 429	\$ 187	\$ 153
Property & equipment (net) .....	8,517	6,405	5,367	4,959	4,649
Investments & long-term receivables ..	616	540	523	615	828
CAPITAL EMPLOYED .....	9,402	7,379	6,319	5,761	5,630
Long-term debt .....	2,571	1,413	1,025	980	873
Deferred income taxes .....	999	757	539	305	202
Deferred gas contract revenue .....	156	—	—	—	—
LONG-TERM LIABILITIES .....	3,726	2,170	1,564	1,285	1,075
Common shares outstanding .....	5,514	5,514	5,407	5,598	5,571
Retained earnings (deficit) .....	162	(305)	(652)	(1,122)	(1,016)
SHAREHOLDERS' EQUITY .....	\$5,676	\$5,209	\$4,755	\$ 4,476	\$ 4,555
Common shares — outstanding .....	5,739,326	5,739,326	5,679,326	5,828,126	5,803,126

### OPERATIONS

#### Production (gross before royalties)

Crude oil & natural gas liquids					
— barrels .....	26,000	28,000	33,000	25,000	26,000
Natural gas — MCF .....	890,000	1,150,000	1,455,000	1,688,000	1,938,000

#### Land

Working interest — gross acres .....	1,838,900	1,939,800	2,958,400	2,859,200	7,880,600
Working interest — net acres .....	1,157,000	1,226,100	2,090,300	2,122,100	5,553,900
Royalty — gross acres .....	3,510,200	3,510,200	3,510,200	4,646,100	4,125,700

#### Drilling Activity

Gross wells drilled .....	32	18	6	7	6
Net wells drilled .....	8	4	3	3	3
Net wells productive .....	6	2	2	3	2
Net wells dry .....	2	2	1	—	1

#### Reserves (gross proven & probable)

Crude oil & natural gas liquids					
— barrels .....	1,310,000	1,306,000	545,000	578,000	500,000
Natural gas — BCF .....	24	22	15	16	17

Employees — at year end .....

8	6	6	5	5
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## CORPORATE INFORMATION

At January 31, 1979

### DIRECTORS

**J. Christopher Barron**

President, Cassels, Blaikie & Co. Limited,  
Toronto, Ontario

**Mervyn S. Devonshire** \* [see footnote]

Partner, Devonshire, Munro & Co.,  
Chartered Accountants, Calgary, Alberta

**William J. Major, Q.C.**

Partner, Major Caron & Company,  
Barristers & Solicitors, Calgary, Alberta

**Timothy C. Melton**

President, Melcor Developments Ltd.,  
Edmonton, Alberta

**Nicholas W. Taylor**

President of the Company,  
Calgary, Alberta

### OFFICERS

**Nicholas W. Taylor**, President

**J. Sheldon Crewson**, Vice President — Exploration

**Allen F. Emes**, Treasurer & Corporate Secretary

### SENIOR PERSONNEL

**Fredrick J. Smith**, Manager — Land

**Grant Auchincloss**, Manager — Geology

### HEAD OFFICE

1106 B.P. House, 333 - 5th Avenue S.W.,  
Calgary, Alberta T2P 3B6

### SUBSIDIARIES AND AFFILIATES

Lochiel Exploration (U.K.) Limited — 100%

Lochiel Exploration Inc. — 100%

Lochiel Oil & Gas (1972) Ltd. — 100%

Petromines Limited — 26%

### REGISTRARS AND TRANSFER AGENTS

Guaranty Trust Company Of Canada  
Calgary, Alberta and Toronto, Ontario

### BANKING

The Toronto-Dominion Bank,

Calgary, Alberta

Morgan Grenfell and Co. Limited,

London, England

### AUDITORS

Touche Ross & Co.

Calgary, Alberta and London, England

### SOLICITORS

Major Caron & Company

Calgary, Alberta

Crane & Hawkins

London, England

### SHARES LISTED (Symbol LHX)

Toronto Stock Exchange

Alberta Stock Exchange


With the untimely death on April 21, 1979, in Calgary of Mervyn S. Devonshire, Lochiel lost its longest-term director. A director of the Company since 1966, Mr. Devonshire was instrumental in the formation and growth of Lochiel.



*1978  
Annual  
Report*

*Lochiel Exploration Ltd.*

*DiTash*  
GRAPHIC SERVICES LTD.

ALCRAFT  CALGARY  
LITHOGRAPHED IN CANADA